IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In Re ENRON CORPORATION SECURITIES, DERIVATIVE & "ERISA" LITIGATION		MDL NO. 1446
This Document Relates To:	§	
	§	
MARK NEWBY, ET AL., Individually and on behalf of all others similarly situated,	§	
	§	
Plaintiffs,	§	CIVIL ACTION NO. H-01-3624
	§	AND CONSOLIDATED CASES
V.	§	
	§	
ENRON CORP., ET AL.,	§	
	§	
Defendants.	§	

DEFENDANT ALLIANCE CAPITAL MANAGEMENT L.P.'S
REPLY MEMORANDUM IN FURTHER SUPPORT OF ITS
MOTION TO DISMISS PURSUANT TO RULE 12(b)(6)

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Defendant Alliance Capital Management L.P. ("Alliance Capital") submits this reply memorandum in further support of its motion, pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, to dismiss plaintiffs' claim allegedly arising under Section 15 of the Securities Act of 1933 (the "1933 Act"), 15 U.S.C. § 77o.

PRELIMINARY STATEMENT

Plaintiffs rely on one paragraph (¶ 83(ee)) among more than 1,000 in their Consolidated Complaint as sole support for their theory that "Alliance controlled and directed Savage in his activities as a director of Enron." (Compl. ¶ 83(ee)) Although plaintiffs have had the benefit of the Powers Report, at least six months of investigation, and numerous congressional hearings, plaintiffs rely on conclusory allegations and gross generalizations to support their claim. Lacking any factual support, plaintiffs assert it should be enough to allege, in the barest of terms, that because Frank Savage ("Savage") worked for Alliance Capital, Alliance Capital must have had the power to control Savage's actions as an outside director of Enron. But something more is required before an entity can be ensnared in a massive class action on a theory of control person liability. Plaintiffs must allege *facts* sufficient to support their supposition that Alliance Capital had the power to control Savage. Plaintiffs' Consolidated Complaint and opposition memorandum demonstrate a cavalier disregard for this fundamental tenet.

Having no adequate response to their critical pleading deficiency, plaintiffs spend the majority of their 25-page memorandum trying to disprove arguments that Alliance Capital did not make. (In fact, it is not until page 16 of their opposition memorandum that plaintiffs even begin to address their failure to allege facts sufficient to demonstrate Alliance Capital's power to control.) Other arguments advanced by plaintiffs simply are not relevant to whether plaintiffs

have adequately pleaded that Alliance Capital had the power to control Savage with respect to his responsibilities as an outside director of Enron.

I. Plaintiffs Have Failed to Plead a Legally Sufficient Claim Under Section 15.

Plaintiffs have pleaded no facts sufficient to support a claim that Alliance Capital had the power to control Savage as to his responsibilities as an outside director on the board of Enron, an unaffiliated corporation. Instead, plaintiffs appear to argue that they have pleaded a legally sufficient claim merely by stating the conclusion that "Alliance controlled and directed Savage in his activities as a director of Enron." (Compl. ¶ 83 (ee)) However, as noted in Alliance Capital's principal brief (Alliance Capital Br. at 6-7) [1], the settled law is to the contrary: plaintiffs "must plead specific facts, not mere conclusory allegations." *Elliot v. Foufas*, 867 F.2d 877, 880-81 (5th Cir. 1989); *accord, Thrift v. Hubbard*, 44 F.3d 348, 356 (5th Cir. 1995) (a plaintiff is required to "'give the defendant fair notice of what plaintiff's claim is and the grounds upon which it rests'") (emphasis added and citation omitted); *Guidry v. Bank of LaPlace*, 954 F.2d 278, 281 (5th Cir. 1992) (stating that "'[c]onclusory allegations and unwarranted deductions of fact are not admitted as true'" by a motion to dismiss) (citation omitted).

This bedrock principle was reaffirmed just four months ago, with specific reference to Section 15 of the 1933 Act and the requirements of Rule 12(b)(6). In *In re Deutsche Telekom AG Sec. Litig.*, No. Civ. 9475, 2002 WL 244597 (S.D.N.Y. Feb. 20, 2002), the court stated:

> KfW contends that plaintiffs have failed to establish a prima facie case of control person liability pursuant to section 15 or section 20(a) because they have failed to allege control person status in anything but conclusory terms. . . .

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[1] Citations to "Alliance Capital Br. ___" are to Defendant Alliance Capital Management L.P.'s Memorandum in Support of Its Motion to Dismiss Pursuant to Rule 12(b)(6), filed May 8, 2002.

> **In order to survive a Rule 12(b)(6) motion, a plaintiff must plead *facts* which support a reasonable inference that they had the potential power to influence and direct the activities of the primary violator. Conclusory allegations that KfW "controlled" Deutsche Telekom are insufficient for the assertion of liability pursuant to sections 15 and 20(a).**

In re Deutsche Telekom AG Sec. Litig., 2002 WL 244597, at *6-7 (all emphasis added, citations and internal quotation marks omitted). There, plaintiffs claimed that control was adequately alleged because the complaint stated that defendant "KfW owned 22 percent of Deutsche Telekom." *Id.* at *6. In dismissing the claim pursuant to Rule 12(b)(6), the court held that even such substantial share ownership was "insufficient by itself to infer control of Deutsche Telekom by KfW." *Id.* Contrary to what plaintiffs assert here, well-pleaded facts are required.

Plaintiffs clearly have failed to allege facts sufficient to support their claim. As in *Deutsche Telekom*, plaintiffs misstate the relevance of share ownership. *See* Pl. Mem. at 22-23.[2] The Consolidated Complaint states: "During 00-01, Alliance was the largest single institutional shareholder of Enron owning over 43 million shares of stock in Alliance mutual funds." (Compl. ¶ 83 (ee)) According to plaintiffs, this ownership created a "huge motive" for Alliance Capital to control Savage. *Id.* But as pointed out in Alliance Capital's principal brief (Alliance Capital Br. at 10), alleging a possible motive to exercise control does not satisfy plaintiffs' burden of pleading facts sufficient to support the power to control Savage. Further, although plaintiffs suggest in their *opposition brief* that Alliance Capital's alleged ownership of Enron shares permitted it to "place an employee/board member on another company's board to protect its financial interest" (Pl. Mem. at 23), *the Consolidated Complaint does not make this allegation.*

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[2] Citations to "Pl. Mem. ___" are to Plaintiffs' Opposition to Alliance Capital Management's Motion to Dismiss, filed June 11, 2002.

In fact, while the Consolidated Complaint vaguely refers to Enron shares owned by Alliance in "00-01" (presumably 2000 and 2001), it does not allege that Alliance Capital owned any shares in 1999 when, as plaintiffs acknowledge, Savage first became an Enron director. (Compl. ¶ 83(ee)) There is no basis whatsoever – well-pleaded or otherwise – to assume that Alliance Capital had the power to appoint Savage to Enron's board and thereby had the power to control him in his capacity as an Enron board member.[3] Additionally – and critically – any "ownership" by Alliance Capital of Enron shares goes not to whether Alliance Capital possessed the power to control Savage, but rather, to whether Alliance Capital had the power to control Enron. There are no allegations that Alliance Capital controlled Enron, so any share ownership is utterly meaningless to the pivotal issue. Moreover, as in *Deutsche Telekom*, plaintiffs' allegations of share ownership are insufficient *as a pleading matter* to state a claim under Section 15. *Deutsche Telekom*, 2002 WL 244597, at *6 (22 percent ownership insufficient to infer control).

Other than the irrelevant allegation that Alliance Capital "owned" shares of Enron in "00-01," plaintiffs' theory of Alliance Capital's power to control Savage rests on the fact that Savage was an employee of Alliance Capital. But plaintiffs have failed to cite a single case where an entity (Alliance Capital) has been deemed to control the actions of an employee (Savage) in his capacity as a director of an unaffiliated corporation (Enron) absent other well-pleaded allegations.[4] As shown above, Alliance Capital's share ownership is irrelevant to this

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[3] The Consolidated Complaint's pleading failures cannot, of course, be remedied by plaintiffs' brief opposing Alliance Capital's motion to dismiss. *See In re Sec. Litig. BMC Software, Inc.*, 183 F. Supp. 2d 860, 915 (S.D. Tex. 2001) (Harmon, J.).

[4] Plaintiffs' inability to provide authority for their position further supports what the Fifth Circuit has already stated – that "Congress's specific purpose in enacting §15 was to impose liability upon persons who controlled corporations committing violations of the Securities Act . . . ." *Paul F. Newton Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1115 (5th Cir. 1980) (emphasis added); *see also* S. Rep. No. 47-73, at 5 (continued...)

analysis, and plaintiffs have alleged no other facts regarding Alliance Capital's power to control Savage's outside activities as a director of Enron.

None of the cases plaintiffs cite support the proposition that they can plead a sufficient claim under Section 15 by making a conclusory allegation of control, unsupported by any well-pleaded allegations of fact. For example, in *Stern v. American Bankshares Corp.*, 429 F. Supp. 818 (E.D. Wis. 1977) (Pl. Mem. at 19), the individuals alleged to be control persons were not unaffiliated companies, but actually the principal officers and/or directors of the allegedly controlled corporation. *Stern*, 429 F. Supp. at 823. Thus, the case goes only to whether an officer or director of a corporation may be deemed to control that corporation.

Similarly, in *Robertson v. Strassner*, 32 F. Supp. 2d 443 (S.D. Tex. 1998) (Pl. Mem. at 21), the group alleged to be controlling persons included the President of the controlled corporation and its Chief Operating Officer. *Id.* at 445. Further, one of the issues addressed by the court in *Robertson* was whether "NGP" (the "controlling shareholder" and "creditor" of OEDC) had the power to control OEDC. *Id.* at 449. Whether an employer has the power to control the outside activities of an employee with respect to the employee's responsibilities as a director of an unaffiliated corporation was not an issue before the *Robertson* court. Thus, plaintiffs' contention that the "basic nature of the fact allegations in *Robertson* are similar to Enron and Alliance," (Pl. Mem. at 21) is false and *Robertson* is inapposite to the issue before this Court.[5]

(continued...)

(1933) (referring to provisions in the 1933 Act aimed at preventing directors from utilizing 'dummy' directors) (emphasis added). *See* Alliance Capital Br. at 4.

[5] Additionally, contrary to plaintiffs' assertion that the control allegations in *Robertson* were "significantly less detailed" (Pl. Mem. at 21) than those alleged here, the *Robertson* complaint contained more facts than (continued...)

In addition, plaintiffs simply are wrong in stating that *Hawkins v. Merrill, Lynch, Pierce, Fenner & Beane*, 85 F. Supp. 104 (W.D. Ark. 1949), held that Merrill Lynch could be "a control person of a non-employee correspondent, notwithstanding lack of any discernible control structure or influence." (Pl. Mem. at 20) In fact, *Hawkins* involved detailed and specific allegations of "control" and "influence":

> [D]efendants [Merrill Lynch] directed Waddy [the controlled person] in the conduct of his business by furnishing him the wire, the cotton ticker, prescribing the form of accounts, prescribing the manner in which accounts . . . were to be handled, furnished part of the forms for the transaction of his business, checked and approved his confirmation forms, made available the services of their research department to him and his customers, furnished market news and various publications pertaining to various industries, and particularly directed him in his compliance with the rules of the exchanges and through dictation of his replies to the SEC enabled him to continue the use of [the account at issue] to the injury of plaintiffs.

Id. at 123 (emphasis added). Further, in *Ruiz v. Charles Schwab & Co.*, 736 F. Supp. 461 (S.D.N.Y. 1990) (Pl. Mem. at 21), the means of "discipline and influence" exercised by the "controlling" brokerage firm included financially compensating the "controlled" investment advisor based on the volume of trading at issue in the case. *Id.* at 462-63. In the present case, no allegation is made that Alliance Capital compensated Savage for his service on Enron's board.[6]

(continued...)

the Consolidated Complaint does. For example, the *Robertson* plaintiffs alleged, among other things, that the controlling company: (i) owned 47% of the controlled company; (ii) was owed $12 million by the controlled company; (iii) was a paid advisor of the controlled company; (iv) received more than $14 million as a result of the offering at issue; and (v) *appointed* one of its owners to the controlled company's board. *See* First Amended Complaint filed in *Robertson v. Strassner*, Civ. No. H-98-0364 at ¶¶ 2, 5, 9, 12, 18, 19, 21, 36, 37, 39 and 47 (filed S.D. Tex., Houston Div., May 18, 1998). Far from supporting plaintiffs' claim, the complaint filed in *Robertson* exposes some of the Consolidated Complaint's gaping deficiencies.

[6] Plaintiffs also make the odd assertion (Pl. Mem. at 18) that the requirements of Section 15 can be met by pleading the existence of an "abstract, indirect" power to control. No reference to "abstract, indirect" (continued...)

II. The Balance of Plaintiffs' Opposing Memorandum Fails to Address Issues Relevant to This Motion.

Having no valid response as to the insufficiency of their pleading, plaintiffs devote the bulk of their brief to misstating Alliance Capital's contentions and then arguing with straw men of their own construction. For example:

- Plaintiffs devote the largest part of their brief (***more than 13 pages***) to arguing the sufficiency of their underlying Section 11 claim against Savage. Alliance Capital's motion did not, however, address the merits of that claim. Alliance Capital simply stated in a footnote that if the Section 11 claim were dismissed for any reason, the Section 15 claim would automatically fail as well. *See* Alliance Capital Br. at 3 n.4.

- Plaintiffs also argue that their Section 15 claim is not subject to the heightened pleading requirements of Rule 9(b). (Pl. Mem. at 2-3) But Alliance Capital never suggested that Rule 9(b) applies to that claim. Rather, Alliance Capital's point is that "[a] complaint which consists of conclusory allegations unsupported by factual assertions fails even the liberal standard of Rule 12(b)(6)." *Deutsche Telekom* 2002 WL 244597 at *3 (quoting *DeJesus v. Sear, Roebuck & Co., Inc.*, 87 F.3d 65, 70 (2d Cir. 1996) (internal quotation marks and additional citations omitted).

- Equally irrelevant to the present motion is plaintiffs' argument that an affirmative defense of good faith under Section 15 raises issues of fact. (Pl. Mem. at 1, 22) Unless plaintiffs first plead facts sufficient to state a claim under Section 15 – which is precisely what they have failed to do – the issue of affirmative defenses does not arise. Alliance Capital does not have to prove a good faith defense to a claim that has not been pleaded properly.

- Plaintiffs' discussion of "*respondeat superior*" is not germane. (Pl. Mem. at 1, 22) On the contrary, the cases and legislative history make it clear that Section 15 is not a broad employer liability provision. (Alliance Capital Br. at 4-6) In any event,

(continued...)

control – whatever that might mean – exists in any of the cases cited by plaintiffs, or in any other authority that we have been able to locate.

nowhere in Alliance Capital's principal brief is the doctrine of *respondeat superior* even mentioned.

- Alliance Capital did not assert, as plaintiffs claim, that plaintiffs must allege the actual exercise of the power to control. (Pl. Mem. at 11 n.7, 17) The Section 15 claim is defective because plaintiffs have failed to plead facts sufficient to demonstrate the power to control.

The bulk of plaintiffs' brief, in fact, consists of efforts to divert attention from the central flaw in their Section 15 claim – the failure to allege facts sufficient to support the charge that Alliance Capital had the power to control Savage with respect to Savage's service as an outside director on Enron's board.

III. Public Policy Considerations Also Militate Against Plaintiffs' Strained Construction of the Statute.

While plaintiffs devote more than a dozen pages to issues not raised by Alliance Capital, they spend only one paragraph attempting to address the serious public policy considerations implicated by their attempt to hold Alliance Capital responsible for the actions of its employee without any well-pleaded allegations that Savage was acting within the scope of his employment or that Alliance Capital had the power to control his outside activities. Under plaintiffs' theory, a company may be subject to years of litigation in federal securities lawsuits as an alleged "controlling person" simply because one of its employees served as an outside director of another company whose public filings are the subject of a lawsuit.[7] Plaintiffs brush this problem aside, saying companies ultimately can avoid *liability* as a control person if the company can show it acted in good faith. (Pl. Mem. at 24) But such companies still would face years of costly

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[7] In fact, plaintiffs suggest that they need only allege, without any factual support, that a company or person had "influence" over a primary violator in order to be entitled to costly discovery. *See generally* Pl. Mem. at 17-18. Thus, plaintiffs equally would be entitled to sue and demand discovery from Savage's family, friends, or anyone else who "may" have had "influence" over his actions.

discovery and litigation before they could assert that defense, and this prospect could deter corporations from permitting their employees to serve as outside directors of other companies.

Failure to require plaintiffs to plead facts sufficient to illustrate Alliance Capital's power to control Savage could result in a dearth of qualified persons willing to fulfill the valuable role of independent director. Indeed, the standard plaintiffs urge this Court to adopt would spawn a new industry for plaintiffs' attorneys around the country. If plaintiffs' theory is accepted, whenever claims are asserted against a company's directors under Sections 11 or 12 of the 1933 Act or Rule 10b-5 under the 1934 Act, control person claims against each director's outside employer also would be asserted as a matter of routine. Such a result clearly would be contrary to the public interest.

IV. Plaintiffs' Request For Leave To Amend Should be Denied.

This Court should not permit plaintiffs another opportunity to assert a futile control person claim against Alliance Capital. Recently, in *In re MCI Worldcom, Inc. Sec. Litig.*, 191 F. Supp. 2d 778 (S.D. Miss. 2002) the court, in denying plaintiffs' request for leave to amend under similar circumstances stated:

> Plaintiffs proceed on an amended complaint filed seven months after this action was commenced. The Court finds that Plaintiffs have had ample opportunity to plead their case. Moreover, the Reform Act mandates dismissal of "any private action arising under this chapter . . . if the [pleading] requirements . . . are not met."

Id. at 794 (citation omitted). The purpose of the PSLRA is to restrict the number of baseless suits. That purpose would be frustrated and the PSLRA would be eviscerated if plaintiffs were permitted to amend their Consolidated Complaint. Should the claim against it be dismissed, Alliance Capital requests that the dismissal be with prejudice.

CONCLUSION

In sum, plaintiffs have failed to plead adequately a Section 15 claim against Alliance Capital. Plaintiffs' extraneous allegation that Alliance Capital "owned" Enron shares simply does not support the claim that Alliance Capital had the power to control Savage. Moreover, plaintiffs' allegation that Savage worked for Alliance Capital, without more, is insufficient to state a claim against Alliance Capital arising out of Savage's activities as an outside director of Enron. Despite virtually constant disclosures in the press, numerous congressional hearings, the Powers Report, and several months to investigate the veracity of their claims, plaintiffs have failed to plead any facts tying Alliance Capital's status as an employer to any power to control Savage's actions as an outside director of Enron. Although certainly not an exhaustive list, the Consolidated Complaint fails to allege, for example:

- that Alliance Capital had the power to and indeed did place Savage on Enron's board;
- that Alliance Capital compensated Savage for his service on Enron's board;
- that Savage's employment at Alliance Capital was contingent upon executing Alliance Capital's bidding while on Enron's board;
- that Savage was financially or otherwise dependent on his employment at Alliance Capital; and
- who at Alliance Capital had the power to control Savage in his role as an Enron director.

Considering the magnitude of this massive class action and the substantial costs associated with defending against one of the largest lawsuits in history, plaintiffs must set forth more than innuendo and conclusory statements.

For the reasons set forth above and those set forth in Alliance Capital's original moving papers, the Consolidated Complaint as to Alliance Capital should be dismissed with prejudice and plaintiffs' request for leave to amend should be denied.

Dated: June 24, 2002

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and foregoing Defendant Alliance Capital Management L.P.'s Reply Memorandum in Further Support of its Motion to Dismiss Pursuant to Rule 12(b)(6) was served on all counsel of record listed on the attached Service List by e-mail, facsimile or posting to www.esl3624.com on this 24th day of June, 2002.

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